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IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

COLGATE-PALMOLIVE CO.,

Petitioner,

v.

FRANCHISE TAX BOARD,
An Agency of the State of California,

Respondent.

On Writ of Certiorari to the Court of Appeal of the State of California for the Third Appellate District

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BRIEF FOR NATIONAL FOREIGN TRADE COUNCIL, INC. AND EMERGENCY COMMITTEE FOR AMERICAN TRADE AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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BRIEF FOR NATIONAL FOREIGN TRADE COUNCIL, INC. AND EMERGENCY COMMITTEE FOR AMERICAN TRADE AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

INTEREST OF THE *AMICI CURIAE*

The National Foreign Trade Council, Inc. (NFTC), established in 1914, consists of approximately 500 U.S.-based manufacturing companies, financial institutions, and other firms with substantial international operations and interests. Its members account for more than 60 percent of all U.S. non-agricultural exports and more than 60 percent of all U.S. private foreign investment. The NFTC's purpose is to develop policies designed to expand exports, protect U.S. foreign investment, enhance the competitiveness of U.S. industry, and promote and maintain a fair and equitable international trading system.

The Emergency Committee for American Trade (ECAT) is an organization of the leaders of approximately 60 large U.S. firms with extensive international business operations. Their annual worldwide sales total well over $1 trillion, and they employ more than five million workers. ECAT's mission is the advocacy of open international economic policies that will expand international trade and investment.

The members of the NFTC and ECAT are concerned that California's use of a "world-wide combined reporting/unitary" (WWCR/Unitary) method for determining corporate income subject to tax in California impairs U.S. foreign economic relations, has incited destructive retaliatory measures by foreign governments, and thereby endangers U.S. business and the U.S. economy. Several of the members of the NFTC and ECAT have been beneficiaries of the competent authority process under various U.S. bilateral tax treaties described below. This process has allowed these members to obtain complete relief from double taxation threatened when both the United States and a foreign jurisdiction initially proposed to tax the same dollar of income. It also has provided complete relief from double taxation between states and foreign jurisdictions in those states which use a "water's edge/unitary" or "arm's length/separate accounting" (AL/SA) method, allowing them to "piggyback" off adjustments to Federal tax. Counsel for the parties have consented to the filing of this brief in letters filed with the Clerk of the Court.

STATEMENT

This case challenges the constitutionality of California's use of WWCR/Unitary for determining the taxable income of a multinational group of corporations owned by a U.S. parent. CAL. REV. & TAX. CODE § 25101 *et. seq.* (West 1992 & Supp. 1993). WWCR/Unitary is a variant of the unitary/formulary apportionment method used by most states for apportioning corporate income among the several states for income tax purposes. All such methods use a formula for apportioning income, typically a three-factor formula involving property, payroll, and sales. Each method determines the income to be apportioned on a "unitary business" basis; that is, the income to be

apportioned is that which is earned in a single business that may cross jurisdictional and separate entity lines.

WWCR/Unitary determines and apportions the income from the unitary business throughout the entire world. Thus, it combines (for apportionment) income of a group of affiliated corporations, including foreign corporations with no income-producing activities in the United States. The "water's edge/unitary" method combines (for apportionment) income only of entities engaged in income-producing activities in the United States; it does not combine income of foreign affiliates that do not have such activities.

The determination of income attributable to entities doing business in the United States under the *water's edge*/unitary approach is done on an AL/SA basis. AL/SA treats U.S. and foreign corporations, although related, as separate accounting entities, dealing at "arm's length" with each other. Where it can be shown that transactions between related foreign and U.S. entities are not at arm's length, *i.e.*, they differ from comparable transactions between unrelated parties, the tax authorities that use AL/SA adjust the income of the domestic entities to reflect that which they would have earned had they dealt at arm's length. Virtually every foreign taxing jurisdiction uses the AL/SA method of determining the taxable income of corporations doing business in that jurisdiction.[1]

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[1] The trial court below in this case stated that

> The unitary method of taxation is not widely used. In international circles it is not used at all in the taxing of multinational corporations. The water's edge method is now used.

Pet. App. F at 88a. (References to the Appendix to the Petition for *Certiorari* in this case are denominated "Pet. App." followed by a letter assigned to each item and a page reference.)

The California Supreme Court stated in the companion case, "The trial court found as a matter of fact that the AL/SA method was the 'international standard of accounting' and that '[n]o other system is used internationally.'" *Barclays* Pet. App. at C-8 n.6. (References to the Appendix to the Petition for

Petitioner is the U.S. parent corporation of a multinational group of corporations including foreign corporations with no activities in California. In the years at issue, California used WWCR/Unitary to include the income of those foreign corporations in its state income base for apportionment. This action has resulted in California's taxing the same dollars of income also taxed by foreign jurisdictions.[2] This brief supports Petitioner's contention that California's action is unconstitutional under the Commerce Clause.[3] The Court of Appeal of the State of California for the Third Appellate District disagreed with Petitioner.

SUMMARY OF ARGUMENT

I.

To validate a state tax that otherwise interferes with foreign commerce, the Federal government must manifest affirmative and unambiguous approval. *Wyoming v. Oklahoma*, 112 S. Ct. 789 (1992); *South Central Timber Development, Inc. v. Wunnicke*, 467 U.S. 82 (1984). In this case, there has been no such approval. Congress's rejection of a provision of the U.S.-U.K. Tax Treaty[4] which would have prevented California's use of WWCR/Unitary is distinctly different from the Federal approval of the international convention at issue in *Wardair Canada, Inc. v. Florida Department of Revenue*, 477 U.S. 1 (1986). In *Wardair*, because the

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Certiorari in the companion case, *Barclays Bank PLC v. Franchise Tax Board*, No. 92-1384, are denominated "*Barclays* Pet. App." followed by a letter assigned to each item and a page reference.)

[2] California no longer mandates the use of WWCR/Unitary. It now permits a taxpayer to elect to use the water's edge/unitary method, computing apportionable income in the United States on the AL/SA basis. CAL. REV. & TAX. CODE § 25110 (West 1992 & Supp. 1993).

[3] U.S. CONST. art. I, § 8, cl. 3.

[4] Convention for the Avoidance of Double Taxation, Dec. 31, 1975, U.S.-U.K., 31 U.S.T. 5670 [hereinafter U.S.-U.K. Tax Treaty].

convention approved applied to 157 countries and, therefore, virtually all foreign commerce involving aviation in Florida, Congress and the Executive had essentially legislated a restriction on certain state taxes (and implicit approval of others) with respect to virtually *all* foreign commerce these taxes might touch. In the case of the rejected provision of the U.S.-U.K. Tax Treaty, on the other hand, the Executive and Congress could deal with foreign commerce with only *one* country. Indeed, the rejection was based upon the fact that broad legislation, applicable to virtually all foreign commerce, was a better route to address the problems presented by WWCR/Unitary.

II.

Because the rest of the world uses AL/SA for computing the taxable income of corporations, California's use of WWCR/Unitary in the years at issue to compute either U.S.-parent group or foreign-parent group unitary income presents a substantial risk of double taxation -- the taxation of the same dollar of income both by California and by foreign jurisdictions -- that burdens foreign commerce. California's use of WWCR/Unitary, viewed against the universal use of AL/SA by foreign jurisdictions, creates a much greater risk of international double taxation than reasonably available alternatives, such as AL/SA. For example, by using AL/SA to determine apportionable income, California could have "piggybacked", like most other states, on the results of Federal-level negotiations under a system of tax treaties that eliminate double taxation in the vast majority of cases. (California does precisely this today.) Because California could have eliminated the significant risk of double taxation presented by its use of WWCR/Unitary had it used AL/SA in the years at issue, such use violates the first of the two additional[5] Commerce Clause tests set forth in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979) and, therefore, is unconstitutional under the Commerce Clause.

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[5] The *Japan Line* case introduced two tests in addition to the four tests applicable to purely interstate commerce, as outlined in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

III.

The Federal government has adopted a uniform policy favoring AL/SA, as shown by the fact that both U.S. domestic law and all U.S. tax treaties guarantee U.S. corporations the right to compute their Federal taxable income using AL/SA. California's use of WWCR/Unitary for both U.S.-parent and foreign-parent multinationals impairs that uniform Federal policy, to the serious detriment of the national interest. It has engendered concrete actions toward retaliation by numerous foreign governments. It also substantially undermines the U.S. government's efforts to ensure that neither U.S.-parent multinationals' investments abroad nor foreign-parent multinationals' investments in the United States are competitively disadvantaged through double taxation. For these reasons, it violates the second *Japan Line* test.

ARGUMENT

I. CALIFORNIA'S USE OF WWCR/UNITARY MUST NOT VIOLATE EITHER OF *JAPAN LINE*'S TWO ADDITIONAL FOREIGN COMMERCE CLAUSE TESTS SINCE THERE HAS BEEN NO UNAMBIGUOUS, AFFIRMATIVE FEDERAL APPROVAL OF THAT USE.

A. The Federal Power to Regulate Foreign Commerce Is Supreme.

Subject to explicit constitutional restraints, the power of Congress to grant protection to interstate or foreign commerce against state regulation or taxation or to withhold such protection is complete. The determination of policy made by Congress must prevail. *State Board of Insurance v. Todd Shipyards Corp.*, 370 U.S. 451, 456 (1962). Congress may discriminate against interstate or foreign commerce and in favor of local trade or it may prohibit such discrimination. *Prudential Insurance Company v. Benjamin*, 328 U.S. 408, 434 (1946). In so doing, Congress may either act alone or it may act in concert with the states by conferring upon the states an ability to restrict the flow of interstate commerce that they would not otherwise enjoy. *Id.* In

either case, the ordinary negative implications of the Commerce Clause as regards a state's power to regulate commerce are irrelevant. *Id.*

B. The Exercise of the Supreme Federal Power to Regulate Foreign Commerce Cannot Be Inferred; It Must Be Unambiguously and Affirmatively Exercised By Constitutional Means.

Because Congress's power over interstate and foreign commerce is supreme, its exercise cannot be lightly inferred. This is particularly true where, as in this case, the state tax which burdens foreign commerce would, if upheld, trigger retaliation by foreign governments against numerous U.S.-based multinational corporations[6] and interfere with a network of bilateral tax treaties.[7] In such a case, there must be an unambiguous, affirmative expression of Congressional approval.

> Congress must manifest its unambiguous intent before a Federal statute will be read to permit or approve ... a violation of the Commerce Clause....

Wyoming v. Oklahoma, 112 S. Ct. 789, 802 (1992).

> [F]or a state regulation to be removed from the reach of the dormant Commerce Clause, Congressional intent must be unmistakably clear. The requirement that Congress affirmatively contemplate otherwise invalid state legislation is mandated by the policies underlying dormant Commerce Clause doctrine.
>
> * * *
>
> The need for affirmative approval is heightened by the fact that [a state's] policy has substantial ramifications beyond the

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[6] U.K. Finance Act, 1985, ch. 54, at 52-54, excerpt from exhibit 35 of trial court record in companion case designated for inclusion in Joint Appendix; *see Barclays* Pet. App. at A-49, ¶ 35.

[7] *See, e.g.*, U.S.-U.K. Tax Treaty, *supra* note 4, art. 9.

> Nation's borders. The need for a consistent and coherent foreign policy enhances the necessity that Congressional authorization not be lightly implied.

South-Central Timber Development, Inc. v. Wunnicke, 467 U.S. 82, 91-92 & n.7 (1984).[8]

This Court's decision in *Wardair Canada, Inc. v. Florida Department of Revenue*, 477 U.S. 1 (1986), despite the conclusion of the court below,[9] does not alter this requirement of an unambiguous and affirmative exercise of the foreign commerce power. Indeed, the Court in *Wardair* found an unambiguous, affirmative exercise of the Federal power to approve a state tax in an international convention[10] to which the United States and 156 other nations were parties:

> Article 24(a) of the Chicago Convention by its terms precludes the imposition of local taxes on fuel only when the fuel is "on board an aircraft ... on arrival ... and retained on board on leaving" a contracting party; it does not prohibit taxation of fuel purchased in that country. 61 Stat. 1186.

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[8] In manifesting its affirmative and unambiguous intent to empower a state to burden foreign commerce, Congress must, of course, act through constitutional means. The constitutional means available to Congress to express its affirmative and unambiguous approval include the enactment of a bill (which, pursuant to U.S. CONST. art. I, § 7, can be vetoed by the Executive in which case a two-thirds vote of both Houses of Congress is required for the bill to become law) or, under U.S. CONST. art. II, the giving of consent (by two-thirds of the Senators present) to a treaty made by the Executive. In either case, of course, the Executive has a major role to play in either initiating or concurring in the affirmative, unambiguous, Congressional approval. For this reason alone, the 20 bills concerning WWCR/Unitary introduced in Congress over the past 20 years but never enacted are irrelevant to this analysis.

[9] Pet. App. B at 16a to 18a.

[10] Convention on International Civil Aviation, *opened for signature* Dec. 7, 1944, 61 Stat. 1180, 1186, 3 Bevans 944, 950 [hereinafter Chicago Convention].

477 U.S. at 10. The Executive, in negotiating the Chicago Convention, and Congress, in ratifying it, had, therefore, (1) specifically addressed the sort of tax at issue in *Wardair*, and (2) specifically prohibited the imposition of this sort of tax at issue in certain circumstances, but (3) not prohibited its imposition in the circumstances presented in the case.

Most importantly, Congress and the Executive did this with respect to an international convention that applied to 157 countries. There was no material foreign commerce left out of this action since virtually all international airlines which might possibly purchase fuel in Florida were covered. This is hardly ratification of a state tax through "governmental silence;"[11] it is, instead, an unambiguous, affirmative statement that covers virtually *all* foreign commerce with respect to the object of the tax at issue.

C. There Has Been No Unambiguous, Affirmative Exercise of the Federal Power to Regulate Commerce That Sanctions California's or Any State's Use of WWCR/Unitary.

Respondent and the courts below rely principally on the Senate's reservation, effectively striking from Article 9(4) of the U.S.-U.K. Tax Treaty[12] any reference to state tax, as the

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[11] Pet. App. B at 16a.

[12] *Supra* note 4; Article 9(4) of the treaty as amended by exchange of diplomatic notes dated April 13, 1976, and presented to the Senate (before application of the reservation) read as follows (bracketed references added):

> Except as specifically provided in this Article:
>
> (a) where an enterprise doing business in one Contracting State [U.S.]:
>
> (i) is a resident of the other Contracting State [U.K.]; or
>
> (ii) is controlled, directly or indirectly, by an enterprise which is a resident of the other Contracting State [U.K.], and
>
> (b) where the enterprise which is a resident of the other Contracting State [U.K.] is a corporation, such corporation is neither:
>
> (i) a controlled foreign corporation within the meaning of section 957 of the United States Internal Revenue Code of 1954 (as it may be amended from time to time without changing the

unambiguous, affirmative exercise of the Federal power to regulate foreign commerce that sanctions California's use of WWCR/Unitary. That reliance is misplaced. There are important differences between the rejection of Article 9(4) and the adoption of the provisions of the Chicago Convention which were dispositive in *Wardair*. Those differences were, not coincidentally, also the chief reasons for the reservation.

The crucial distinction between this case and *Wardair* is that in *Wardair*, as discussed above, the convention at issue applied to virtually *all* foreign commerce, while here the rejected provisions of Article 9(4) of the U.S.-U.K. Tax Treaty would have applied only to foreign commerce with enterprises located in, or related to enterprises located in, a *single* other nation, namely the U.K. In *Wardair*, because the Federal exercise of the foreign commerce power was an exercise with respect to virtually *all* foreign commerce touched by the state taxation of aviation fuel, the exercise was uniform, rather than piecemeal. The adoption of the Chicago Convention was akin to legislating approval of certain forms of state aviation fuel taxation. The Senate's ratification process gave Congress an opportunity to consider the issue of state aviation fuel taxation as it applies to virtually *all* international air

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general principle thereof); nor

(ii) created or organized under the laws of the first-mentioned Contracting State [U.S.] or of any third State or controlled, directly or indirectly, by a corporation which is a resident of any third State;

then, in determining the tax liability of the first-mentioned enterprise in the State [U.S.] in which it does business, or in a political subdivision or local authority of that State [California], such State [U.S.], political subdivision or local authority [California] shall not take into account the income, deductions, receipts or outgoings of a related enterprise which is a resident of the other Contracting State [U.K.] or of an enterprise of any third State which is related to the enterprise of the other Contracting State [U.K.], except that this prohibition shall not apply where the first-mentioned enterprise is resident of the first-mentioned Contracting State [U.S.], to the extent that it owns, directly or indirectly, the capital of the related enterprise [in the U.K.].

reprinted in 3 CCH TAX TREATIES ¶ 10,936.

traffic. In this case, on the other hand, the consideration of Article 9(4) of the U.S.-U.K. Tax Treaty gave the Senate no such opportunity to consider the impact of WWCR/Unitary on virtually *all* foreign commerce.

In addition, as presented to the Senate, Article 9(4) would not have prevented California's use of WWCR/Unitary with respect to U.S.-parent multinational groups.[13] The resulting discrimination against U.S.-parent groups with U.K. affiliates further narrowed the already narrow impact of Article 9(4)[14] and may have raised competitiveness concerns about the provision's unbalanced impact on U.S.-U.K. trade and investment.

The too-narrow impact of Article 9(4) is an important reason why Article 9(4) was rejected. Even the sponsor of the reservation, as the court below in *Barclays* points out, objected to Article 9(4) as much for procedural as substantive reasons:

> Explaining one of the motivations behind the reservation, which in effect struck Article 9(4) from the treaty, its chief proponent objected to the Executive Branch use of "the device of a tax treaty" to "impose major changes in internal tax policy" by circumventing Congressional consideration of the State's use of formula apportionment. (Remarks of Sen. Church, 124 Cong. Rec. 18416 (1978).)

Barclays Pet. App. at C-29. The rejection of Article 9(4) therefore, was not approval of California's use of WWCR/Unitary, but rather was an expression of a desire to deal with the matter in a more comprehensive fashion, *e.g.*, by domestic legislation. As then-Senate Minority leader Howard Baker explained:

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[13] *See supra* note 12; *see also* U.S. State Department, Letter of Submittal (June 8, 1976) *reprinted in* 3 CCH TAX TREATIES ¶ 10,938, p. 44,528.

[14] *Cf.* Article 9(4) *as quoted by* the California Supreme Court, *Barclays* Pet. App. at C-28.

> In adopting its reservation to Article 9(4) in June of 1978, the Senate appeared to reach a consensus that domestic legislation, as an alternative to international treaty language, is preferable in regulating that conduct of the States which may affect foreign commerce.[15]

The continuing omission of a provision like Article 9(4) in tax treaties presented for ratification since the U.S.-U.K. Tax Treaty debate simply reflects the desire of both the Executive and Congress to deal with the matter in a comprehensive rather than piecemeal fashion.

D. Since There Has Been No Unambiguous, Affirmative Federal Approval of California's Use of WWCR/Unitary, *Japan Line*'s Two Tests Control This Case; If the California Tax Contravenes Either, It Is Unconstitutional Under the Commerce Clause.

Because Congress has not unambiguously, affirmatively ratified California's use of WWCR/Unitary, this Court must determine whether the Commerce Clause's "self-executing limitation on the power of the states to enact laws imposing substantial burdens on [interstate and foreign] commerce," *South Central Timber*, 467 U.S. at 87, has been violated. Under *Japan Line*, "two additional considerations, beyond those articulated in *Complete Auto*, come in to play" where, as in this case, "a state seeks to tax the instrumentalities of foreign commerce," 441 U.S. at 446. The first is an enhanced risk of multiple taxation. The second is an impairment of Federal uniformity in an area where Federal uniformity is essential. "If a state tax contravenes either of these precepts, it is unconstitutional under the Commerce Clause." *Japan Line*, 441 U.S. at 451. California's use of WWCR/Unitary contravenes both.

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[15] COMM. ON FOREIGN RELATIONS REP. ON THE THIRD PROTOCOL TO THE 1975 INCOME TAX CONVENTION WITH THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND, AS AMENDED, S. EXEC. REP. No. 5, 96th Cong., 1st Sess. 15 (1979), *reprinted in* 3 WG&L TAX TREATIES ¶ 89,075.

II. CALIFORNIA'S USE OF WWCR/UNITARY VIOLATES THE FIRST OF *JAPAN LINE*'S TWO TESTS BECAUSE IT PRESENTS A SUBSTANTIAL RISK OF DOUBLE TAXATION THAT COULD BE ELIMINATED BY THE USE OF REASONABLY AVAILABLE ALTERNATIVES.

In *Japan Line*, this Court held that "[e]ven a slight overlapping of tax -- a problem that might be deemed *de minimis* in a domestic context -- assumes importance when sensitive matters of foreign relations and national sovereignty are concerned." 441 U.S. at 456 (footnote omitted). As Respondent is sure to emphasize, however, that statement is not the end of the analysis on the first *Japan Line* test. This Court in *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983), added the further requirement that the substantial risk of double taxation presented by the challenged state tax be reasonably avoidable by the taxing state:

> Although double taxation in the foreign commerce context deserves to receive close scrutiny, that scrutiny must take into account the context in which the double taxation takes place and the alternatives reasonably available to the taxing State.

463 U.S. at 189.

A. California's Use of WWCR/Unitary Presents a Substantial Risk of Double Taxation.

For purposes of determining whether California's use of WWCR/Unitary creates a substantial risk of international double taxation, that use "must be evaluated in the realistic framework of the custom of nations." *Japan Line*, 441 U.S. at 454. It must be compared to the allocation or apportionment methods actually used by foreign jurisdictions, since California and this Court are powerless to change those methods. For *Japan Line* analysis purposes, it cannot be evaluated in isolation or in a hypothetical comparison to another jurisdiction using WWCR/Unitary. Since

virtually all foreign jurisdictions use AL/SA,[16] the relevant question is whether the use of WWCR/Unitary creates a substantial risk of double taxation when the entity or affiliated group subject to tax is also subject to tax under AL/SA.[17]

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[16] *See* authorities cited *supra* note 1. The uniform international acceptance of AL/SA for determining corporate income attributable to a national jurisdiction is a product mostly of the post-World War II world economy. Indeed, it is only with the interwoven network of bilateral tax treaties that have developed mostly since the 1950's, JOSEPH ISENBERGH, INTERNATIONAL TAXATION, Vol. II, at 322, 323 (1990), that AL/SA has become not only predominant but mandatory. *See* discussion *infra* p. 19. Early authorizations of formulary apportionment in a multinational setting, therefore, (*e.g.*, *Bass Limited v. Tax Commission*, 266 U.S. 271 (1924)) are not pertinent, since they preceded the relatively recent, mandatory uniform use of AL/SA in the international context.

[17] Even if foreign jurisdictions changed their tax systems to use some version of the unitary method of income apportionment, there would still be a substantial risk of double taxation. *See* Eric J. Coffill and Prentiss Willson, Jr., *Federal Formulary Apportionment As an Alternative to Arm's Length Pricing: From the Frying Pan to the Fire?*, 59 TAX NOTES 1103, 1114 (May 24, 1993). One prominent problem arises from different applications of the apportionment factors. For example, a growing number of states (including California) do not use a uniform three-factor (*i.e.*, payroll, property, and sales) formula for apportioning income but rather give extra weight to the sales factor.

> The rationale behind the movement is that it enables the state to "tax the other guy" while at the same time purporting to create a friendly business climate and to promote economic development within the state. For in-state taxpayers who make sales to out-of-state buyers, the double-weighting of the sales factor tends to attribute income out of the state, thereby decreasing the taxpayer's income tax liability to the state of origin. For out-of-state taxpayers who make sales into the state, the double-weighting of the sales factor tends to increase the amount of the taxpayer's income that is attributable to the state. This decreasing of the tax load of in-state citizens at the expense of out-of-state sellers understandably develops fond adherents among politicians who must periodically seek votes from the former but not the latter.

Corrigan, *Weighting the Sales Factor*, MULTI-STATE TAX COMMISSION REVIEW, June 1987, at 9. Were the unitary method to be used worldwide, it could be expected that countries with wage rates one-tenth those prevailing in developed countries would double-, triple-, or even greater weight the payroll factor in order to make up for the disparity, contributing substantially to multiple taxation.

The record below, as well as the record below in the companion case, establishes that significant double taxation has resulted and can easily result when WWCR/Unitary is used domestically and AL/SA is used abroad. Pet. App. F at 88a to 89a; *Barclays* Pet. App. at A-25; *cf. Container*, 463 U.S. at 188. As described in the decision below, Petitioner has argued in this case that California's use of WWCR/Unitary apportioned 70 percent more income to California than would use of AL/SA. Pet. App. B at 20a. While the court below compared this figure to the 250 percent over-apportionment to the state in *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123 (1931), and found that the 70 percent over-apportionment did not violate the "external consistency" requirement for apportionment formulas, Pet. App. B at 21a, that finding related only to the "fair apportionment" requirement applicable to all Commerce Clause inquiries, whether interstate or foreign. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). The crucial additional inquiry in a foreign commerce case such as this is whether an "overlapping of tax" of that magnitude represents a "substantial risk of double taxation." Such a risk clearly exists in this case.[18]

B. The Use of AL/SA By California Would Virtually Eliminate the Risk of Double Taxation.

California had a reasonable alternative to eliminate the risk of double taxation between itself and foreign jurisdictions created by

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[18] Moreover, this Court should note that, unlike the case with a *property* tax such as that considered in *Japan Line*, the over-apportionment of *income* resulting from a conflict of allocation methods can be infinite on a percentage basis. Where, on an AL/SA basis, a taxpayer in California has a loss (a not uncommon situation for many multinationals in the recent recession), any allocation of positive taxable income via the use of WWCR/Unitary can create, mathematically, an infinite percentage over-apportionment.

its use of WWCR/Unitary. Indeed, like most other states, it now uses that alternative: it allows taxpayers to elect to use AL/SA.[19]

There are two reasons why the use of AL/SA by California in the years at issue would have virtually eliminated the risk of double taxation. First, while the differences between the use of AL/SA among jurisdictions that use that method are not negligible, *see, e.g., Container*, 463 U.S. at 191, those differences are far smaller than the differences that exist in this case, the companion case, and many cases where WWCR/Unitary conflicts with AL/SA. Second, and far more important, the network of U.S. bilateral tax treaties with more than 45 other nations[20] provides a comprehensive and effective mechanism, called competent authority negotiations, to resolve differences in the application of AL/SA by the respective taxing authorities. As described below, this competent authority negotiation process results in elimination of double taxation in the vast majority of cases. If California had used AL/SA in the years at issue it could have, as it and many states do today, "piggybacked" upon the result negotiated by Federal authorities to virtually eliminate the risk that it would tax the same dollar of income being taxed by a foreign jurisdiction.

1. *The Use of AL/SA by California Would Present Far Fewer Opportunities for Double Taxation Than Its Use of WWCR/Unitary Presents.*

Since the potential conflicts between WWCR/Unitary and AL/SA must be analyzed in measuring the risk of double taxation, it is virtually axiomatic that California could substantially reduce that risk by using AL/SA. This is because, notwithstanding the

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19 *See supra* note 2.

20 Included in this number are the republics of the former Union of Soviet Socialist Republics, as to which the Convention for the Avoidance of Double Taxation, June 20, 1973, U.S.-USSR, 27 U.S.T. 1, remains in force. *See* Rev. Proc. 93-22A, 1993-38 I.R.B. 10. Not included are jurisdictions such as Aruba, Bermuda, and the Netherlands Antilles, with respect to which the United States does not have comprehensive double taxation treaties in force.

potential for some double taxation among jurisdictions using AL/SA, the use of a method that is at least theoretically consistent with the system used by all foreign jurisdictions is far less likely to create a risk of double taxation than a method that is theoretically at odds with that method. Moreover, AL/SA is subject to continual refinement by Federal statutory and regulatory amendment with respect to substantive rules,[21] procedural rules for maintaining and supplying relevant information for its enforcement,[22] and penalties.[23] Importantly, these efforts are frequently coordinated by the Federal government with most U.S. tax treaty partners, chiefly through discussions and informal agreement reflected in the work of the Organization for Economic Cooperation and Development (OECD).[24]

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21 *See, e.g.*, Tax Reform Act of 1986, Pub. L. No. 99-514, § 1231(e)(1), 100 Stat. 2085, 2561, *et. seq.* (1986) (amending 26 U.S.C. § 482); Prop. Treas. Reg. §§ 1.482-1 and 1.482-2, 57 Fed. Reg. 3571 (1992); Temp. Treas. Reg. §§ 1.482-0T through 1.482-7T (1993); Prop. Treas. Reg. §§ 1.482-1T(f)(2), 1.482-2(g), and 1.482-6T, 58 Fed. Reg. 5310 (1993).

22 *See, e.g.*, Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7403, 103 Stat. 2106, 2358-59 (1989) (amending 26 U.S.C. § 6038A); Prop. Treas. Reg. §§ 1.6038A-0 through 1.6038A-7, 55 Fed. Reg. 50706 (1990); Treas. Reg. §§ 1.6038A-0 through 1.6038A-7 (1991).

23 *See, e.g.*, Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11312, 104 Stat. 1388-1, 1388-454, 1388-455 (1990) (amending 26 U.S.C. § 6662); Prop. Treas. Reg. §§ 1.6662-0, 1.6662-5, 1.6664-0, and 1.6664-4, 58 Fed. Reg. 5304 (1993); Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13236, 107 Stat. 312, 505-506 (1993) (amending 26 U.S.C. § 6662).

24 *See, e.g., Model Tax Convention on Income and Capital*, OECD Committee on Fiscal Affairs [hereinafter CFA] (1992) (commentary on Article 9); *Transfer Pricing and Multinational Enterprises*, OECD CFA (1979); *Transfer Pricing and Multinational Enterprises, Three Taxation Issues*, OECD CFA (1984); Internal Revenue Service, *Report on the Application and Administration of Section 482*, App. E, ¶ 10.2 (April 1992), [hereinafter IRS § 482 Report], *reprinted in* BNA DAILY TAX REPORTER No. 70, at S-1, *and also reprinted in* 92 TNT 77-19 (April 10, 1992); *Transfer Pricing Penalties are Discretionary, Treasury Official Says*, TAX NOTES TODAY, Sept. 13, 1993, at 3267 (quoting former IRS Commissioner Shirley D. Peterson as saying the first thing she did as Commissioner "was to travel to Paris and listen to the

2. *The Competent Authority Process Under Tax Treaties Provides a Very Effective Mechanism for Eliminating Any Double Taxation That Does Arise.*

This Court in *Container* noted that "double taxation is sometimes mitigated by provisions in tax treaties providing for intergovernmental negotiations to resolve differences in the approaches of the respective taxing authorities." 463 U.S. at 192 n.31. This mechanism for relieving double taxation by intergovernmental negotiation is known as the competent authority or mutual agreement procedure. *See generally* U.S.-U.K. Tax Treaty, *supra* note 4, art. 25; U.S. Treasury Model Income Tax Treaty,[25] art. 25.

Container accurately identifies the competent authority process as a potential means to achieve consistency among taxing authorities whose basic approach to income allocation is quite similar, *i.e.*, where both use AL/SA. 463 U.S. at 192 n.31. It also appears to conclude, however, that this potential is not achieved because (1) California is not in a position to benefit from the fruits of the competent authority negotiation, and (2) competent authority negotiations are ineffective in generally avoiding double taxation, *Id.* *Amici*, many of whose members have eliminated foreign versus Federal *and* foreign versus state double taxation through the use of the competent authority process, respectfully suggest that the *Container* Court was not adequately informed of the broad availability and effectiveness of competent authority negotiations or of the means by which states can and do adjust state taxable income (and tax) on the basis of such negotiations.

OECD and to U.S. trading partners regarding transfer pricing"); *The U.S. Proposed Regulations Dealing with Tax Aspects of Transfer Pricing Within Multinational Enterprises*, OECD CFA (January 10, 1993), *reprinted in* BULLETIN FOR INTERNATIONAL FISCAL DOCUMENTATION, Jan. 1993, at 21.

[25] U.S. Department of the Treasury, *Model Income Tax Treaty* (1981), *reprinted in* 1 CCH TAX TREATIES ¶ 211 [hereinafter Model Tax Treaty].

A primary goal of the U.S. network of bilateral income tax treaties, like the income tax treaties of other nations, is the mitigation or elimination of double taxation through consistent treatment of transactions by both taxing authorities.[26] Between a corporation and its subsidiary or between two subsidiaries, this is typically achieved through the application of the "Associated Enterprises" article. *See, e.g.*, U.S.-U.K. Tax Treaty, art. 9(1); Model Tax Treaty, art. 9(1).

Paragraph 1 of Article 9 of the typical U.S. tax treaty provides, in effect, that when arrangements between two related enterprises differ from those that would exist between independent enterprises, *i.e.*, the arrangements are not at arm's length, then adjustments may be made so that the arrangements are as they would be if the separate enterprises had bargained at arm's length. Where an income allocation under this authority is made by one country, many treaties require that the other country make a "correlative adjustment," a corresponding decrease in the taxable income of the related party in that jurisdiction to reflect the adjustment made in the other. *See* U.S.-U.K. Tax Treaty, art. 9(2); Model Tax Treaty, art. 9(2). Where one of the countries disagrees with the allocation made by the other, the "competent authorities" must consult and endeavor to reach agreement under the mutual agreement procedures outlined in Article 25 (Mutual Agreement Procedure) of the typical U.S. tax treaty. U.S.-U.K. Tax Treaty, art. 9(3); Model Tax Treaty, art. 9(2). Article 25 also independently provides that a U.S. taxpayer may seek relief from the U.S. competent authority when it considers itself subject to "taxation not in accordance with the provisions of [the treaty]," irrespective of the remedies provided by U.S. domestic law.

This competent authority process is open to all taxpayers confronted with double taxation involving treaty countries or taxation inconsistent with a tax treaty. The procedure for

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[26] IRS § 482 Report, *supra* note 24, at 5-2; American Law Institute, FEDERAL INCOME TAX PROJECT, INTERNATIONAL ASPECTS OF UNITED STATES INCOME TAXATION II -- PROPOSALS ON UNITED STATES INCOME TREATIES 5 (1992) [hereinafter ALI].

implementing and prosecuting a request, Rev. Proc. 91-23, 1991-1 C.B. 534, is as straightforward as any Internal Revenue Service procedure.[27] It is successfully utilized by scores of taxpayers each year.[28] When a request for competent authority assistance under Article 25 is made (whether in the context of an Article 9 adjustment or independently under Article 25), the U.S. competent authority *must*, if the claim is justified, implement a unilateral solution if it is appropriate and, in other cases, *must* attempt to resolve the claim through mutual agreement with the treaty partner.[29] While it is true that an agreement is not mandatory, competent authorities are required to make a good-faith effort to resolve each individual case. *Id.* The U.S. competent authority[30] takes its responsibilities under Articles 9 and 25 of the U.S. income tax treaties seriously:

> Because transfer pricing adjustments have an impact on two or more national tax administrations, the section 482 enforcement process demands a well-functioning process for resolving double taxation cases. Allocation cases involv[ing] transfer pricing issues ... account for about 70 percent to 75 percent of the competent authority case inventory. It is important for taxpayers faced with economic double taxation to have not only a means for seeking relief, but also confidence that the matter will be fairly and expeditiously resolved.[31]

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[27] Rev. Proc. 91-23 superseded Rev. Proc. 82-29, 1982-1 C.B. 481, which had superseded Rev. Proc. 70-18, 1970-2 C.B. 493.

[28] IRS § 482 Report, *supra* note 24, at 5-5.

[29] ALI, *supra* note 26, at 101.

[30] The Secretary of the Treasury or his delegate is designated as the U.S. competent authority in U.S. treaties. *See* Model Tax Treaty, *supra* note 25, art. 3(1)(e)(i). Under Delegation Order No. 114 (Rev. 9), 1990-2 C.B. 326, the U.S. competent authority function has been assigned to the Assistant Commissioner (International) of the IRS.

[31] IRS § 482 Report, *supra* note 24, at 5-2.

Even more important than the seriousness with which the U.S. competent authority takes its responsibility to negotiate in good faith is its exceedingly high rate of success. According to figures provided to Congress, the U.S. competent authority was able in recent years to provide complete relief from double taxation for 77 to 79 percent of the twice-taxed dollars involved, and partial relief for an additional 16 to 19 percent.[32] IRS § 482 Report, *supra* note 24, at 5-5. Thus, in fiscal 1991, for example, full or partial relief from double taxation was provided through the competent authority process for over $500 million (representing 96 percent of the dollars at issue) that, but for the competent authority process, would also have been subject to tax in another jurisdiction. *Amici* respectfully suggest that a failure rate of competent authority negotiations as low as 4 to 5 percent indicates that the competent authority process presents just the sort of "central coordinating authority" (that eliminates any substantial risk of double taxation between two jurisdictions both using AL/SA) found wanting in *Container*, 463 U.S. at 192.

3. *The Advance Pricing Agreement Procedure Provides Another Effective Mechanism to Avoid Double Taxation.*

While the competent authority process has historically been used to deal with the resolution of disputes that arise upon the examination of past tax years, a relatively new process has developed, also under the authority of Articles 9 and 25 of the typical bilateral U.S. tax treaty, to achieve agreement between U.S. and foreign tax authorities on allocations of income in advance. This process, known as the Advance Pricing Agreement or APA process, is described in Rev. Proc. 91-22, 1991-1 C.B. 526. Under the APA process, a taxpayer first negotiates with the IRS to determine the applicable transfer pricing methodology and the acceptable range of results in applying that methodology to the taxpayer's situation. Then the IRS, under the mutual agreement

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[32] Thus, through negotiations, either the foreign jurisdiction or the U.S. (or both) reduced taxable income.

authority contained in the U.S. bilateral tax treaties, negotiates with a foreign tax authority. When both tax authorities are in agreement, the tax authorities and the taxpayer enter into a "closing agreement"[33] that binds the tax authorities and the taxpayer for a period of several years in the future. In this fashion, taxpayers and both U.S. and foreign tax authorities can agree in advance to appropriate allocations and avoid future disputes.

While the APA program is less than three years old, and intended chiefly for larger taxpayers with more complicated cases, it appears to be successful. The IRS Director of the program has reported that there are currently 49 taxpayers engaged in the APA program at various stages and that eight completed APAs have involved competent authority agreements with foreign tax authorities.[34]

4. *Were California to "Piggyback" Off the Federal Determination of Income, As Most States Do, It Could Take Advantage of the Competent Authority and Advance Pricing Agreement Processes to Virtually Eliminate the Risk of Double Taxation.*

Container is correct in its statement that California is in no position itself to negotiate with foreign governments regarding potential allocation disputes. 463 U.S. at 192 n.31. It is also technically correct that neither *tax treaties* nor *Federal law* provides a mechanism by which the U.S. Federal competent authority can directly negotiate double taxation arising out of state tax systems. *Id.* What was not taken into account in *Container*, however, is that most *state income tax laws* (including California's today) provide effective mechanisms to take advantage of the

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[33] A closing agreement is a written agreement between a taxpayer and the IRS relating to the taxpayer's tax liability. 26 U.S.C. § 7121.

[34] Robert Ackerman *et al.*, *The Advance Pricing Agreement (APA) Program: A Model Alternative Dispute Process*, 2 TAX MANAGEMENT TRANSFER PRICING, Special Report No. 9, 6 (December 1, 1993).

success of the competent authority and APA processes. These mechanisms ensure conformity between Federal treatment of potential double tax problems, as resolved through competent authority or APA proceedings, and state tax treatment. Taken together, and given the high success rate of double tax elimination at the Federal level, these mechanisms effectively eliminate the risk of double taxation of income between the states and foreign jurisdictions. This simple, effective, and widely used means to avoid double tax between states and foreign jurisdictions gives California today (and gave it in the years at issue) a more than "reasonably available alternative" to avoid double tax within the meaning of *Container*, 463 U.S. at 189.[35]

First, more than forty states (including California today) begin their taxable income calculations with an amount based on Federal gross income, net income, or taxable income figures.[36] Any subsequent final changes or corrections made to Federal tax items, due either to amendment of the Federal return or to assessment or refunds by Federal authorities, trigger obligations to notify the appropriate state tax commission promptly.[37] Any such Federal adjustments trigger an appropriate adjustment to state tax liability,

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[35] The availability of this mechanism also belies the suggestion that use of AL/SA would require California to defer automatically to allocation determinations made by various foreign governments. *Cf. Container*, 463 U.S. at 193.

[36] ALL STATES TAX HANDBOOK, ¶ 221 (Mendoza, Klutkowski, Curammeng, and Vassallo, eds., 1992), [hereinafter ALL STATES HANDBOOK]. *See, e.g.*, PA. STAT. ANN. tit. 72, § 3420n-2 (1981 & Supp. 1993); FLA. STAT. § 200.12 (1990 & Supp. 1992); ILL. ANN. STAT., ch. 35, ¶ 5/203 (Smith-Hurd 1993); N.J. REV. STAT. § 54:10A-4 (1986 & Supp. 1993); N.Y. TAX LAW § 208(9) (Consol. 1986 & Supp. 1993).

[37] ALL STATES HANDBOOK ¶ 232. *See, e.g.*, PA. STAT. ANN. tit. 72, §§ 7406 and 7407 (1990 & Supp. 1993) (within 30 days); FLA. STAT. § 220.23 (1990 Supp. 1992) (within 60 days); ILL. ANN. STAT., ch. 35, ¶ 5/506 (Smith-Hurd 1993) (within 120 days); N.J. REV. STAT. § 54:10E-11 (1986 & Supp. 1993) (within 90 days); and N.Y. TAX LAW § 211 (Consol. 1986 & Supp. 1993) (within 90 days).

in the form of either an additional assessment by the state tax authorities or a refund claim by the taxpayer.[38]

As an added measure of reliability in conforming state tax assessments with Federal tax liability, many states utilize tax information sharing provisions. Pursuant to 26 U.S.C. § 6103(d), Federal tax returns and return information are open to inspection by, or disclosure to, any state agency, body, or commission charged under the laws of such state with responsibility for administration of state tax laws. Similarly, most states have enacted parallel provisions, providing for disclosure to the IRS of tax information received by state tax administrations.[39]

California itself has enacted mechanisms to ensure consistency of state tax treatment with negotiated positions of the U.S. competent authority, at least with respect to its taxpayers electing to use the water's edge/unitary method. Under California's tax law,[40] corporate franchise taxable income is defined as net income, which itself is defined as gross income less deductions. "Gross income," in turn, means gross income under 26 U.S.C. § 61, except as modified by the state.

If any taxpayer's Federal gross income or deductions for any tax year of any taxpayer are changed or corrected by the "Commissioner of Internal Revenue or other officer of the United States or other competent authority," or if the Federal tax return is amended, the taxpayer must report to California the change, correction, or amendment. CAL. REV. & TAX. CODE § 25432 (West 1992 & Supp. 1993). If a Federal change is made and a

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[38] *See, e.g.*, PA. STAT. ANN. tit. 72, § 7407 (1990 & Supp. 1993); FLA. STAT. § 220.23 (1990 & Supp. 1992); ILL. ANN. STAT., ch. 35, ¶¶ 5/903 and 5/905 (Smith-Hurd 1993); N.J. REV. STAT. §§ 54:49-6 and 54:49-14 (1986 & Supp. 1993); and N.Y. TAX LAW §§ 1081, 1083, and 1087 (Consol. 1987 & Supp. 1993).

[39] ALL STATES HANDBOOK, ¶ 235.

[40] CAL. REV. & TAX. CODE §§ 24271 and 24341 (West 1992 & Supp. 1993).

report is timely filed, a state claim for credit or refund may be filed, CAL. REV. & TAX. CODE § 26073.4, or, if the change is adverse to the taxpayer (and whether or not a report is filed), deficiencies may be assessed by the state, CAL. REV. & TAX. CODE §§ 25673, 25674.

Upon the resolution of double tax issues by the U.S. competent authority and resulting adjustments to Federal returns, correlative adjustments to state returns will be made in more than 40 "piggyback" states, thus giving consistent effect to the decision of the competent authority and virtually eliminating any substantial risk of double taxation between the state and foreign jurisdictions.

III. CALIFORNIA'S USE OF WWCR/UNITARY PREVENTS THE FEDERAL GOVERNMENT FROM SPEAKING WITH ONE VOICE, THUS VIOLATING THE SECOND OF *JAPAN LINE*'S TWO TESTS.

A. California's Use of WWCR/Unitary Impairs a Uniform Federal Policy Favoring AL/SA.

The second *Japan Line* test provides that a state tax will violate the Foreign Commerce Clause if it "impair[s] federal uniformity in an area where federal uniformity is essential," 441 U.S. at 448, thus preventing the Federal government "from 'speaking with one voice' in international trade." 441 U.S. at 452; *see also Container*, 463 U.S. at 193. The evidence indicates that there is a uniform Federal policy favoring AL/SA and disfavoring WWCR/Unitary.

As noted by this Court in *Container*, 463 U.S. at 184, the Federal government has adopted AL/SA for Federal income tax purposes. In addition, the United States has entered into a broad network of bilateral double tax treaties which require use of AL/SA for Federal and foreign tax purposes and require correlative adjustments when income is re-allocated to reflect arm's

length arrangements.[41] Moreover, contrary to the apparent understanding of this Court in *Container*, 463 U.S. at 196 & n. 35, and of the California Court of Appeal in its initial decision below, Pet. App. E at 58a, U.S. treaties do *not* waive the requirement to use AL/SA with respect to the U.S. taxation of U.S. corporations. While the so-called "saving clause" of U.S. tax treaties[42] generally preserves the U.S. government's right to tax domestic corporations as if the treaty did not exist, specific exceptions to the saving clause guarantee U.S. corporations the right to be taxed under AL/SA by the United States, as well as access to the mutual agreement procedure to enforce that right.[43] These exceptions reflect the understanding that such treaty rights would be meaningless if they did not apply to U.S. corporations for U.S. tax purposes.[44] In fact, the United States has acknowledged U.S. residents' entitlement to these treaty benefits even if the relevant treaty does not contain an explicit exception from the saving clause to cover them.[45] Domestic corporations

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[41] *See* discussion *supra* p. 19.

[42] *E.g.*, Model Tax Treaty, *supra* note 25, art. 1(3) (General Scope).

[43] Thus, Article 1 (General Scope) of the Model Tax Treaty, *supra* note 25, provides in relevant part as follows:

> 3. Notwithstanding any provision of this Convention *except paragraph 4*, a Contracting State may tax its residents ... as if the Convention had not come into effect ...
>
> 4. The provisions of paragraph 3 shall not affect:
>
> (a) the benefits conferred by a Contracting State under *paragraph 2 of Article 9 (Associated Enterprises)* ... and under *Article ... 25 (Mutual Agreement Procedure)* ....

(emphasis added).

[44] *See, e.g.*, 1 J. Ross McDonald, ANNOTATED TOPICAL GUIDE TO U.S. INCOME TAX TREATIES 186 (1993); ALI, *supra* note 26, at 230; 2 New York University, Proceedings of the Fortieth Annual Institute on Federal Taxation, § 31.04[3] (1982).

[45] *See, e.g.*, U.S. Department of the Treasury, *Technical Explanation to U.S.-Trinidad and Tobago Tax Treaty* (1970), *reprinted in* 3 CCH TAX TREATIES ¶ 9750, p. 43,024-25.

are entitled to these treaty benefits without regard to whether they are subsidiaries of foreign parent corporations or parents of foreign subsidiaries.

Thus, by its use of WWCR/Unitary, California contradicts an international taxing method which the Federal government has both universally applied and sought the universal commitment of its treaty partners to apply as well.

B. California's Use Of WWCR/Unitary Prevents the Federal Government From Speaking With One Voice In an Area Where Federal Uniformity Is Essential.

WWCR/Unitary violates the "one voice" standard because it "implicates foreign policy issues which must be left to the Federal Government." *Container*, 463 U.S. at 194. As this Court has noted, foreign commerce is "preeminently a matter of national concern." *Japan Line*, 441 U.S. at 448. The Federal government's uniform policy of offering and demanding the use of AL/SA throughout its substantial treaty network amply demonstrates the national significance of the choice of taxing method.

The fact that neither Federal legislation nor any treaty *directly* prohibits the states' use of WWCR/Unitary may indicate that the Federal government has not acted with preemptive force, but it in no way lessens the obligation to consider the national interest in speaking with one voice. As this Court noted in *Container*, the most obvious foreign policy implication of WWCR/Unitary is that it could offend foreign governments and lead them to retaliate against the United States as a whole, 463 U.S. at 194. Any uncertainty this Court may have had about its competence to evaluate the risk of foreign retaliation when it considered *Container* in 1983 should have evaporated by 1993, in light of the concrete actions toward retaliation that various governments have

taken in the interim.[46] Moreover, these threats of retaliation are not wholly restricted to displeasure over the application of WWCR/Unitary to foreign-parent multinationals.[47]

In considering the interest of foreign governments in the level of California's taxation of domestic corporations in *Container*, this Court stated that "the amount of tax a domestic corporation pays is much more the function of California's tax rate than of its allocation method," and that the Court "can only assume" that a foreign government's sense of offense would be "attenuated at best" regardless of whether California imposed a certain tax liability by way of WWCR/Unitary or through simply raising its corporate tax rate, 463 U.S. at 195. *Amici* respectfully submit that *Container's* assumption was not well-founded.

Governments' foreign economic policy interests in preventing double taxation encompass *both* protecting their corporations' investments abroad *and* attracting corporate investors from abroad into their own marketplace.[48] Thus, the interest of foreign governments in seeing that U.S. corporations are not subjected to double taxation as a result of WWCR/Unitary is two-fold: (1) ensuring that such double taxation is not a barrier to the ability of foreign-parent multinationals to invest and compete on a level playing field in the United States, and (2) ensuring that it is not a barrier to the ability of U.S.-parent multinationals to invest and compete on a level playing field in foreign countries. In the case of foreign-parent multinationals, their U.S. subsidiaries will not be able to compete on equal terms with local companies in the

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[46] *See* Supplemental Brief of Petitioner on Petition for a Writ of *Certiorari*, *Barclays Bank PLC v. Franchise Tax Board*, No. 92-1384, at 3-5.

[47] *See, e.g., Resolution of the Finance Committee of the German Bundestag Concerning Unitary Taxation in the State of California*, July 1, 1993, *reprinted in* 7 TAX NOTES INTERNATIONAL 165, 93 TNI 135-23 (July 19, 1993).

[48] This duality of interests (*i.e.*, in the ability of domestic-based investors to compete abroad and in the ability of foreign-based investors to compete in the host country) is a well recognized reason for governments' decisions to enter into bilateral tax treaties. *See, e.g.*, ALI, *supra* note 26, at 1-2.

marketplace of a WWCR/Unitary jurisdiction if the U.S. subsidiaries' taxable income is liable to be inflated through WWCR/Unitary, beyond that of their purely local competitors, by inclusion of profits which have been earned by foreign affiliates and taxed abroad. In the case of U.S.-parent multinationals, they will be less able to establish foreign subsidiaries that can compete on equal terms with local companies in the foreign jurisdiction if some of the income earned by the foreign subsidiary and taxed abroad is also currently attributed to the U.S. parent under WWCR/Unitary and subjected to additional tax, not suffered by their foreign competitors, in the WWCR/Unitary jurisdiction. In both cases, it is the *allocation method* of the WWCR/Unitary jurisdiction, and not its *tax rate*, which is the cause of the concern. Thus, foreign governments have just as much reason to object to California's use of WWCR/Unitary as applied to U.S.-parent multinationals as they do with respect to foreign-parent multinationals.

Moreover, as this Court has noted, a state tax "may, of course, have foreign policy implications other than the threat of retaliation." *Container*, 463 U.S. at 195. In this case, contrary to the view expressed by the court below, Pet. App. E at 58a to 61a, the Federal government has a foreign commerce interest in the extent to which WWCR/Unitary prevents U.S.-parent multinationals from competing effectively in foreign marketplaces.[49] California's use of WWCR/Unitary undermines this interest because it causes simultaneous, unrelieved double (*i.e.*, foreign and California) taxation of the income of the U.S. multinationals' foreign subsidiaries, thereby placing them at a competitive disadvantage versus purely foreign corporations in the *foreign* market. Nothing comes closer to the heart of the concerns underlying the Commerce Clause. Citing "the principle of ensuring competitive balance among similarly situated businesses," the Executive Branch, through the Treasury Department, has on

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[49] This interest is quite independent of the Federal desire to ensure competitive balance for U.S.-parent and foreign-parent multinationals in the *domestic* marketplace.

numerous occasions announced its opposition to states' application of WWCR/Unitary to both foreign-parent and U.S.-parent multinationals.[30]

CONCLUSION

California's use of WWCR/Unitary in the years at issue created a substantial risk of double taxation that could have been avoided through the use of reasonably available alternatives, as it is today through the use of AL/SA and "piggybacking" off Federal competent authority negotiations. The use of WWCR/Unitary also interferes with a uniform Federal policy favoring AL/SA that is essential to avoid impediments to international trade and unfair tax treatment of U.S. multinational corporations. Since the Federal government has not unambiguously and affirmatively approved California's use of WWCR/Unitary, this Court should reverse the California Court of Appeal and hold that California's use of WWCR/Unitary violates the Commerce Clause.

Respectfully submitted,

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[30] *See Barclays* Pet. App. at A-64; Hearings before the Subcomm. on Taxation and Debt Management of the Senate Finance Comm. 3 (1986) (testimony of J. Roger Mentz, Assistant Secretary of the Treasury (Tax Policy)), *microformed on* Doc. 86-6319 (Tax Analysts).